

Calpine Energy Services, L.P.
50 West San Fernando Street
San Jose, California 95113

The California Department of Water Resources, with respect to its responsibilities pursuant to California Water Code Section 80000 *et seq.* regarding the Department of Water Resources Electric Power fund, separate and apart from its powers and responsibilities with respect to the State Water Resources Development System (the "*Department*") and Calpine Energy Services, L.P. ("*Calpine*") entered into a Master Power Purchase and Sale Agreement (Version 2.1; modified 4/25/00) ("*Master Agreement*"), including an Amended and Restated Cover Sheet entered into April 22, 2002 and effective May 1, 2002 (the "*Cover Sheet*") and an Amended and Restated Confirmation Letter entered into April 22, 2002 and effective May 1, 2002, (amending and restating the Confirmation Letter dated February 26, 2001), as amended by that certain Amendment entered into as of October 27, 2003 (the "*Confirmation Letter*") (the Confirmation Letter and, to the extent applicable to the Confirmation Letter, the Master Agreement and the Cover Sheet are referred to collectively as the "*Calpine 2 Agreement*"). All capitalized terms used in this letter (this "*Letter*") and not otherwise defined herein shall have the meanings provided in the Calpine 2 Agreement.

Pursuant to the Special Condition 4 of the Confirmation Letter, if Calpine fails to achieve any of the major milestones for the Otay Mesa Project set forth in Special Condition 4(a)(ii)(A) of the Confirmation Letter by the relevant major milestone date specified therein (as any such date may be extended for a period equal to the duration of any period of Force Majeure), and such failure is not cured within 90 days, then the Department will be entitled, within 60 days of Calpine's failure to cure, to exercise its step-in right in accordance with Special Condition 4(d) of the Confirmation Letter (the "*Step-in Right*") and have the identified rights assigned to the Department with regard to the Otay Mesa Project.

As of the effective date of this Letter, Calpine has not achieved the 7/31/03 or the 10/31/03 major milestones for the Otay Mesa Project, to wit, Calpine has not begun pouring major foundation concrete (the "*7/31/03 Major Milestone*"), nor has Calpine begun installation of major equipment (the "*10/31/03 Major Milestone*"). However, Calpine and the San Diego Gas and Electric Company ("*SDG&E*") have proposed entering into a power purchase agreement with regard to the Otay Mesa facility (such power purchase agreement as referred to and described in Prepared Direct Testimony of SDG&E witness Latimer P. Lorenz served in Rulemaking 01-10-024 on December 11, 2003 (the "*Testimony*") being hereinafter referred to as the "*SDG&E Agreement*"), and due to the parties' desire to have adequate time to discuss and evaluate possible permanent modifications to the Otay Mesa construction schedule, the parties wish to extend the cure periods associated with the 7/31/03 Major Milestone and the 10/31/03 Major Milestone and the Department is willing to temporarily suspend the exercise of its Step-in Right pursuant to Special Condition 4(d) of the Confirmation Letter.

Calpine has previously asserted that certain delays in achieving the 7/31/03 Major Milestone were caused by Force Majeure (the "*Existing Force Majeure Claim*"). Calpine hereby waives any right to either assert (a) the Existing Force Majeure Claim, or (b) any new event of Force

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Majeure, to extend any Major Milestone deadline with respect to Otay Mesa under the Calpine 2 Agreement.

Calpine and the Department hereby agree to extend Calpine's 90-day cure periods with respect to the 7/31/03 Major Milestone and the 10/31/03 Major Milestone to a date (the "Cure Period End Date") 30 days after the date on which each of the conditions (the "Conditions") set forth in paragraph 4 under the caption "III. CALPINE PURCHASE POWER AGREEMENT TERM SHEET; B. Calpine Term Sheet; 4. Conditions to Commencement of Contract Term" of the Testimony (relevant excerpts of which are attached hereto as Schedule 1) have been met or waived. The intention of these modifications is to have the cure periods for both the 7/31/03 and the 10/31/03 Major Milestones expire on the Cure Period End Date. The Department's right to exercise its Step-in Right under Special Condition 4 with regard to either the 7/31/03 Major Milestone or the 10/31/03 Major Milestone, or both, shall begin on the day following the Cure Period End Date (unless Calpine has achieved the Major Milestone in question prior to such date), and shall run for 60 days from the day following the Cure Period End Date.

All of the other remaining milestones with respect to the Otay Mesa Project, the cure periods and Step-In Right exercise periods associated therewith shall remain as set forth in the Calpine 2 Agreement, unaffected by this Letter.

Notwithstanding anything to the contrary in this Letter or the Calpine 2 Agreement, if the Cure Period End Date has not occurred on or prior to March 30, 2005, Calpine's cure periods shall end immediately upon written notice from the Department and the Department may thereafter exercise its Step-in Right under Special Condition 4 upon written notice at least 60 days prior to date specified in such notice for the exercise of such Step-in Right; provided, however, that upon occurrence of the Cure Period End Date at any time after March 30, 2005, Calpine's cure periods shall end immediately and the Department shall have 60 days following the Cure Period End Date to exercise its Step-in Rights.

With the exception of the changes expressly set forth herein, nothing in this Letter is intended to construe or modify the Calpine 2 Agreement. This Letter may be executed in any number of counterparts, and upon execution by the Department and Calpine, each executed counterpart shall have the same force and effect as an original instrument and as if the Department and Calpine had signed the same instrument. Any signature page of this Letter may be detached from any counterpart of this Letter without impairing the legal effect of any signatures thereon, and may be attached to another counterpart of this Letter identical in form hereto but having attached to it one or more signature pages.

This Letter shall be effective as of October 29, 2003.

Very truly yours,

DEPARTMENT OF WATER RESOURCES

with respect to the Department of Water Resources Electric Power Fund separate and apart from its powers and responsibilities with respect to the State Water Resources Development System

By:

Name: *Peter S. GARRIS*

Title: *Deputy Director*

Acknowledged and Agreed:

CALPINE ENERGY SERVICES, L.P.

By:

Name: *James Macias*

Title: *Executive Vice President*